Transfer Pricing Express | Issue #3

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Ireland Update

Transfer pricing developments in 2017 to date

Introduction: During 2017, there has been a number of key developments in Ireland's transfer pricing regime that taxpayers should be aware of.

A number of these developments arise as a result of the OECD Base Erosion and Profit Shifting ("BEPS") project such as the introduction of Country by Country Reporting ("CbCR").

On the dispute resolution front, we are seeing an increased audit focus from Irish Revenue on transfer pricing matters. This is not unexpected as the resources dedicated to audits is increased and with the general increase in tax disputes internationally. In addition, Irish Revenue published guidelines in relation to requesting mutual agreement procedure assistance and correlative adjustments in 2017.

2017 version of OECD Transfer Pricing Guidelines – impact for Ireland: In July 2017, the OECD issued a cumulative update to the OECD Transfer Pricing Guidelines. The updates mainly reflect the work of the OECD BEPS project including significant amendments to chapters I, II, V, VI, VII and VIII of the guidelines.

Currently, Ireland's domestic transfer pricing laws are contained in Part 35A of the Taxes Consolidation Act of 1997 ("TCA 1997"). Part 35A specifically refers to the 2010 version of the OECD Transfer Pricing Guidelines.

Our analysis of the impact of the new guidelines can be found by following this link.

Transfer Pricing Documentation Obligations: Ireland's transfer pricing regime was formally introduced for accounting periods beginning on or after 1 January 2011. Ireland's regime introduced a formal transfer pricing documentation requirement for companies within the scope of the regime. The law specifically refers to the 2010 version of the OECD Transfer Pricing Guidelines. In Tax Briefing 07 of 2010, Irish Revenue published details on the transfer pricing requirements in Ireland, including the type of documentation that should be kept. For guidance on transfer pricing documentation, Irish Revenue refer to Chapter V of the 2010 version of the OECD Transfer Prying Guidelines and EU Transfer Pricing Documentation ("EU TPD") as good documentation practice. This tax briefing was reissued in August 2017. Interestingly, there is no mention of the OECD Action 13 changes which introduce a two-tier transfer pricing documentation requirement of a Master File and Local File. At the time of writing, the timeline for formal adoption of the 2017 version of the OECD Transfer Pricing Guidelines into domestic law (which include a new Chapter V on documentation) is still awaited.

For details of the reissued tax briefing, please follow this link to the Irish Revenue website.

Country By Country Reporting Guidance Notes: As per our first issue of Transfer Pricing Express in November 2016, Irish Revenue have formally introduced the CbCR aspects of Action 13 of the BEPS project. The first notifications for Irish constituent entities within scope of CbCR was 31 December 2016.

As part of the introduction of CbCR in Ireland, Irish Revenue published a helpful guide containing frequently asked questions and answers regarding CbCR. The latest version of this guide was issued in July 2017.

This updated guide can be found on the Irish Revenue website by following this link.

On the dispute resolution front, we are seeing an increased audit focus from Irish Revenue on transfer pricing matters.

Dispute Resolution: Since 2015, a dedicated transfer pricing audit team has been undertaking formal transfer pricing audits in Ireland. The primary role of the team is to undertake risk-driven audits. Per Irish Revenue's annual report for 2016, issued in April 2017, there were twelve transfer pricing audit cases open. The focus since inception has been companies that are dealt with by the Large Cases Division ("LCD") within Irish Revenue. LCD deals with the largest Irish headquartered and multinational group companies.

In their annual report, Irish Revenue indicated that the audit programme would be extended to other divisions outside LCD in 2017. Therefore, we can expect that medium sized groups will be a focus of scrutiny from this point forward. Over the last twelve months we have also seen Irish Revenue recruit additional personnel to resource their audit programme and we expect this trend to continue.

In August 2017, Irish Revenue published guidelines for requesting Mutual Agreement Procedure ("MAP") assistance in Ireland. The guidelines set out the process through which taxpayers can seek assistance from Ireland's Competent Authority to resolve matters of double taxation. Irish companies may seek MAP assistance under the relevant article of a double taxation treaty or under the EU Arbitration Convention.

The guidelines outline the time limit for making a MAP request, the information required to be submitted at the time of making a MAP request and the factors that the Irish Competent Authority will consider in determining whether to accept a MAP request. The guidelines set out the minimum information that should be provided to the Irish Competent Authority as part of the process.

The guidelines also set out the applicable procedures to be followed where a taxpayer seeks a correlative adjustment in Ireland. In such as case, a foreign associated company may have settled a transfer pricing audit unilaterally with a foreign tax authority with respect to a transaction(s) with an Irish associated company. The Irish company may make a claim to Irish Revenue for a correlative adjustment to seek a tax refund in Ireland. The guidelines outline that a claim for a correlative adjustment is treated separately by Irish Revenue to a request for MAP assistance.

Irish Revenue will consider requests for correlative adjustments to the extent they consider the foreign tax adjustment to be at arm's length. The guidelines also contain a list of information and documentation that is required to be submitted with a request for a correlative adjustment.

The MAP guidelines can be found on the Irish Revenue website but following this link.

Ireland's position on the Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting ("MLI"):

Together with 67 other countries, Ireland was one of the signatories of the MLI at a signing ceremony held in Paris in June 2017. Prior to the signing ceremony, the Department of Finance in Ireland released a position paper setting out Ireland's stance on the various articles of the MLI. This included Ireland's reservation on adopting certain permanent establishment ("PE") provisions as set out in Action 7 of the OECD BEPS project.

Ireland has 72 tax treaties and the MLI will enable Ireland to update the majority of these treaties to ensure they comply with the BEPS recommendations without the need for separate bilateral negotiations. Ireland will include 71 tax treaties as being covered by the MLI. The Department notes that it has been agreed to exclude one existing treaty which is currently being renegotiated (the US tax treaty).

Our commentary on the position adopted by the Department of Finance on the MLI can be found at the following link.

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OECD Update

2017 OECD Transfer Pricing Guidelines

In July 2017, the OECD released the 2017 updated version of the OECD Transfer Pricing Guidelines.

The updates mainly reflect the work of the OECD BEPS project including significant amendments to chapters I, II, V, VI, VII and VIII of the guidelines.

These changes include amendments resulting from BEPS Action 8-10 (Aligning Transfer Pricing Outcomes with Value Creation) and Action 13 (Transfer Pricing Documentation and Country by Country Reporting).

In addition, the updated guidelines include:

- The revisions to Chapter IX to conform the guidance on business restructurings to the revisions introduced by the 2015 BEPS reports on Actions 8-10 and 13. These conforming changes were approved by the OECD Council in April 2017;
- The revised guidance on safe harbours in Chapter IV. These changes were approved by the OECD Council in May 2013; and
- Consistency changes that were required in the rest of the Transfer Pricing Guidelines to produce the 2017 consolidated version of the guidelines. These consistency changes were approved by the OECD's Committee on Fiscal Affairs on 19 May 2017.

Our Deloitte alert on this can be found by following this link.

Additional guidance on Country-By-Country Reporting

In April, May and July 2017, the OECD published further guidance for tax administrations and MNE Groups on CbCR (Base Erosion and Profit Shifting (BEPS) Action 13).

The additional guidance follows on from a publications issued in June and December 2016, in which the OECD provided support enhancing the consistent implementation of CbCR, through elaboration of the notification requirements for MNE Groups during the transitional implementation phase.

The April 2017 guidance clarifies a number of interpretation issues relating to data to be used in CbCRs as well as to the application of the model legislation contained in the BEPS Action 13 report to assist jurisdictions with the introduction of domestic rules.

In May 2017, the OECD updated its guidance for local filing requirements of CbCRs. The OECD outlines in the guidance that local filing does not form part of the Action 13 minimum standard and that it should only be needed in exceptional circumstances.

Where local filing is applicable, the OECD advises countries that such rules should be limited to three specific circumstances:

- No CbCR obligation by residence jurisdiction;
- Exchange available between the jurisdictions but no qualifying agreement in place yet;
- Systematic failure to exchange CbCRs.

In July 2017, the OECD released updated guidance on the implementation of CbCR. This guidance deals with two specific issues:

- Whether aggregated data or consolidated data for each jurisdiction is to be reported;
- How to treat an entity owned or operated by two or more unrelated MNE groups.

All guidance published up to July 2017 is consolidated into this guidance document and it will only be necessary to refer to the July 2017 guidance going forward.

Our Deloitte alert on the July 2017 OECD release can be found by following this link.

OECD releases Discussion Draft in relation to Hard to Value Intangibles

In May 2017, the OECD released a public discussion draft in relation to the transfer pricing aspects of hard-to-value-intangibles ("HTVIs"). The draft supplements the approach set out in Action 8-10 of the BEPS project.

The discussion draft sets out the principles for implementation of the HTVI approach and includes three examples to clarify the approach. The relationship between the HTVI approach and access to the mutual agreement procedure ("MAP") is also outlined.

For more information in relation to the discussion draft, please refer to our Deloitte alert which can be found here.

OECD releases revised Discussion Draft on Profit Splits

In June 2017, the OECD issued a revised discussion draft on profit splits which replaces an earlier discussion draft from July 2016. The new discussion draft addresses a number of unresolved issues from the 2016 draft including:

- whether to retain the guidance issued relating to a value chain analysis;
- whether to retain the distinction between parallel and sequential integration of an MNE as a tool for tax authorities and taxpayers in considering the use of the profit split method as most appropriate method;
- whether the guidance on when the split of actual profits would be the most appropriate method in comparison with those circumstances in which a split of anticipated profits would be most appropriate could be clarified and simplified;
- consideration of whether a profit split requires both participants to make unique and valuable contributions;
- consideration of acceptable profit split keys and application.

The current draft results in more simplified guidance compared to the 2016 draft. Comments on the document are invited by September 2017 with a public consultation to be held in November 2017.

For more information in relation to the revised discussion draft, please refer to our Deloitte alert which can be found here.

OECD releases new Discussion Draft on Attribution of Profits to Permanent Establishments

In June 2017, the OECD issued a new discussion draft which deals with the work in relation to Action 7 of the BEPS project: *Preventing the Artificial Avoidance of Permanent Establishment Status*. The draft contains additional guidance on the attribution of profits to a permanent establishment ("PE") and sets out high level principles for the attribution of profits to a PE including:

- where a PE arises from article 5 of the OECD Model Tax Treaty, including examples of a commissionaire structure for the sale of goods, an online advertising sales structure and a procurement structure;
- where a PE is created due to changes in article 5 paragraph 4 including an example on the profit to be attributed arising from the anti-fragmentation rule contained in article 5.

For more information in relation to the new discussion draft, please refer to our Deloitte alert which can be found here.

Multilateral Instrument for Implementing BEPS in Tax Treaties

On 24 November 2016, the OECD released the widely-anticipated text of the Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting ("MLI"). An explanatory statement that accompanied the release provided clarification of the approach taken and how each article is intended to affect treaties covered by the MLI. The MLI is designed to implement swiftly the tax treaty related measures arising from the G20/OECD BEPS project. It includes a number of minimum standards that jurisdictions signing up to the MLI are required to implement. The MLI supports all previously agreed BEPS approaches by allowing jurisdictions to select from alternative options, which they will do by filing "technical reservations." The MLI includes articles on permanent establishment ("PE"), treaty abuse, dispute resolution and hybrid mismatches. Changes to the effect of double tax treaties always will be prospective and are subject to jurisdictions both signing up to and ratifying the MLI. The MLI does not address any domestic law changes that are needed.

Background: The final BEPS reports outlined the consensus reached by the OECD, G20 members and other participating countries including amongst others, recommendations included tax treaty-related measures to be reflected in the OECD model tax treaty.

Full implementation of these measures also requires existing double tax treaties to be updated with an *ad hoc* group of more than 100 jurisdictions tasked with the swift facilitation and revision thereof. The developed text, adopted in November 2016 has the capability to apply to both the UN and OECD model treaties and covers aspects including:

- **Treaties covered:** Jurisdictions will provide the OECD with a proposed list of treaties to update under the MLI, which will be modified within agreed parameters.
- **Mechanism for modifying double tax agreements:** Amendments applied will exist alongside the existing treaty, modifying its application. Consolidated version may be applied.
- **Flexibility:** Members are committed to the introduction of measures countering treaty abuse and improving dispute resolution. Significant flexibility exists on how this is achieved, accommodating specific tax treaty policies ensuring the MLI is widely compatible.
- **Clarity and transparency:** The OECD will publish the proposed list of treaties as provided by Jurisdictions. The *Inclusive Framework on BEPS* will review and monitor whether its members' treaties, as modified by the MLI, satisfy the BEPS minimum standards.

Overview: The MLI only includes treaties relating to taxes on income with measures broadly based on the agreed amendments to the OECD model treaty set out in the 2015 final BEPS reports; i.e. hybrid mismatches, treaty abuse, PE, improving tax dispute resolution and mandatory arbitration.

Timetable and entry into effect: The MLI was open for signature from 31 December 2016. On 7 June 2017, over 70 Ministers and other high-level representatives participated in the signing ceremony, including Ireland.

Following signing, domestic ratification will be required to the constitutional arrangements. Finalisation will occur once five jurisdictions have ratified the domestic elements of the convention. Following a period of three months after the date of ratification by the fifth state, the MLI will enter into force for those five jurisdictions at the start of the subsequent calendar month. The same three-month period will apply for all other jurisdictions that subsequently ratify the MLI.

The MLI can enter into effect for a specific treaty only after the three-month period has expired for both jurisdictions. The default timings are:

- Modified withholding tax provisions will have effect for payments made after the first day of the following calendar year; and
- Changes relating to taxes levied with respect to taxable periods will have effect for taxable periods beginning on or after a period of six calendar months has elapsed (or less if both parties agree).

Jurisdictions can unilaterally replace the term "calendar year" with "taxable period" for their own application, and vice versa (potentially leading to asymmetry).

Different provisions apply for dispute resolution and cases could be eligible even where the dispute relates to a period before the MLI was in force. The inclusion of a three-month period after ratification and before the MLI enters into force provides businesses with time to understand and apply the new rules. The first changes made by the MLI are likely to have effect from 1 January 2018 at the earliest.

OECD MLI matching database: In July 2017, the OECD issued its matching database (beta version) which outlines how the MLI modifies a tax treaty between two jurisdictions.

The link to the OECD database can be found here.

OECD releases peer review documents for assessment of BEPS minimum standards (Actions 5 and 13)

The OECD released key documents in February 2017, approved by the Inclusive Framework on BEPS, which form the basis of the peer review of Action 13 Country-by-Country Reporting and for the peer review of the Action 5 transparency framework.

The Action 13 standard on CbCR and the Action 5 standard for the compulsory spontaneous exchange of information on tax rulings (the "transparency framework") are two of the four BEPS minimum standards. Each of the four BEPS minimum standards is subject to peer review in order to ensure timely and accurate implementation and thus safeguard the level playing field. All members of the Inclusive Framework on BEPS commit to implementing the minimum standards and participating in the peer reviews.

The documents released form the basis on which the peer review processes will be undertaken. The compilations include the terms of reference which sets out the criteria for assessing the implementation of the minimum standard and the methodology which sets out the procedural mechanism by which jurisdictions will complete the peer review, including the process for collecting the relevant data, the preparation and approval of reports, the outputs of the review and the follow-up process.

For more information of the peer review and monitoring process, please visit the following OECD links – (i) BEPS Action 5 and (ii) BEPS Action 13.

OECD releases 2015 Mutual Agreement Procedure statistics

The OECD's work to advance tax certainty specifically includes work to improve the timeliness of processing and completing mutual agreement procedure ("MAP") cases under tax treaties and to enhance the transparency of the MAP process. As part of this work, the OECD makes available to the public, via its website, annual statistics on the MAP caseloads of all its member countries and of non-OECD economies that agree to provide such statistics.

MAP statistics for the 2015 reporting period have been made available by the OECD. The report covers opening and ending inventory of MAP cases for 2015, the number of new MAP cases initiated, the number of MAP cases completed, cases closed or withdrawn, and the average cycle time for cases completed, closed or withdrawn cases.

- **Overall 2015 inventory**: statistics indicate the 6,176 open cases reported for the period, resulting in a 14% increase over 2014 data and a 163% increase compared to the 2006 period.
- **MAP cases initiated**: OECD member countries saw an 11% increase in new MAP cases initiated in 2015, rising to 2,509 cases from 2,259 in 2014.
- **MAP cases completed**: 809 cases were reportedly completed over the 2015 period, representing an increase in completion rates of approximately 67% in comparison to the 484 cases completed in 2014.

- **Average cycle time for cases completed, closed or withdrawn**: For the OECD countries for which data was provided, the average time for the completion of MAP cases with other OECD member countries in 2015 was 20.47 months, a slight decrease of 2014 average cycle times of 23.79 months.

The link to the OECD MAP statistics can be found here.

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European Union Update

Public Country-by-Country Reporting

The framework: As tax transparency has gained particular importance as a tool in the fight against tax avoidance and tax evasion, European Union ("EU") is looking to make a further step by providing publicly available information relating to tax paid at the place where profits are actually made. Public CbCR reporting is the publication of a defined set of facts and figures by large MNEs, thereby providing the public with a global picture of the taxes MNEs pay on their corporate income.

The proposed directive: In April 2016, the European Commission issued a proposed directive which required ultimate parent undertakings governed by the national laws of a member state to publish annual reports on their income tax information when their consolidated net turnover exceeded €750 million. It also required non-affiliated undertakings with net turnover exceeding €750 million to publish their information.

The amendments: In December 2016, the Slovak EU Council Presidency published an amended proposal on public CbCR. The amended proposal required ultimate parent undertakings to release their information when their balance sheet exceeds €750 million *for the prior two financial years* based on their consolidated financial statements. In addition, member states would not apply the publication rules to non-affiliated undertakings, ultimate parent undertakings, and affiliated undertakings that operate only in their state.

As amended, the directive stated that public CbCR complements the European Union Council's work to fight corporate income tax avoidance by enhancing public scrutiny of the corporate income taxes paid by MNEs carrying out activities in the European Union as *"Such public scrutiny can be achieved by means of a report on income tax information, irrespective of where the ultimate parent undertaking of the multinational group is established,"*.

To ease the administrative burden on multinational groups, the proposed amendments would remove the requirement that reporting specifications be based on Action 13 of the BEPS project. Instead, groups would be allowed to prepare the information based on the reporting specifications laid down in the annexes of Council Directive 2011/16/EU on mandatory automatic exchange of information. However, at the first meeting of the member states' technical level representatives in January 2017, the text was rejected.

In February 2017, the EU Parliament's members of the Committee on Economic and Monetary Affairs ("ECON") and the Committee on Legal Affairs ("JURI") published their draft legislative recommendations on public CbCR.

The main recommendations to the text are the following:

1. Large groups, as defined in Article 3(7) and all large undertakings as defined in Article 3(4) should be subject to the new disclosure requirements i.e. no threshold of €750 million.
2. The scope of the measure should be worldwide and not be limited to information related to the EU and tax havens or non-cooperative jurisdictions.
3. The format of the reporting companies will need to be standardised in order to allow data comparison.

The current state: The proposal is being considered by the European Parliament ("EP") and the Council. In the EP, the ECON and JURI committees jointly voted their report on 12 June 2017.

For further information relating to public CbCR, please follow this link to European Parliament Think Tank.

Statistics on the Advanced Pricing Agreements (APAs) in the EU

An APA is an agreement between a taxpayer and tax authority determining the transfer pricing methodology for pricing the tax payer's related party transactions. The methodology can be applied for a certain period of time based on the fulfillment of certain terms and conditions (called critical assumptions).

An APA's purpose is to prevent disputes between a tax administration and the taxpayer with respect to the covered transactions and to prevent the risk of double taxation. It provides certainty about the selected transfer pricing methodologies and may mitigate audit exposure with regard to major transfer pricing issues. Within the APA framework, tax administrations and taxpayers cooperate with each other in a non-adversarial environment.

At this point, it is important to make the distinction between unilateral, bilateral and multilateral APAs.

- **Unilateral APA:** an APA that involves only the tax payer and the tax authority of the country where the tax payer is located.
- **Bilateral APA (BAPA):** an APA that involves the tax payer, associated enterprise (AE) of the tax payer in the foreign country, tax authority of the country where the tax payer is located, and the foreign tax authority.
- **Multilateral APA (MAPA):** an APA that involves the tax payer, two or more AEs of the tax payer in different foreign countries, tax authority of the country where the tax payer is located, and the tax authorities of AEs.

This distinction is important as a bilateral APA provides certainty to taxpayers that the covered transfer pricing issues will not be subject to audit adjustments by the tax authorities of either country taking part in the APA, provided of course that the terms and conditions are satisfied.

Bilateral APAs are gradually becoming the preferred route for businesses seeking certainty as to their transfer pricing policies.

The table below provides a summary of the EU Joint Transfer Pricing Forum statistics on APAs in the EU at the end of 2015. For further information relating to the APA Statistics in EU, please follow this link.

MS	APA options available[1]	Total number of APAs in force		Total number of bilateral and multilateral APAs in force		Total number of unilateral APAs in force	
		EU	Non-EU	EU	Non-EU	EU	Non-EU
Belgium	U|B|M	395	16	14	1	381	15
Bulgaria	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Czech Republic	U|B|M	43	4	1	-	42	4
Denmark	B|M|AR	3	13	3	13	-	-
Germany	U|B|M	12	13	12	13	-	-
Estonia	n/a	n/a	n/a	n/a	n/a	n/a	n/a

[1] U=Unilateral, B=Bilateral, M=Multilateral, AR=Advanced Rulings

MS	APA options available[1]	Total number of APAs in force		Total number of bilateral and multilateral APAs in force		Total number of unilateral APAs in force	
		EU	Non-EU	EU	Non-EU	EU	Non-EU
Ireland	B|M	4	4	4	4	-	-
Greece	U|B|M	1	-	-	-	1	-
Spain	U|B|M	45	15	14	1	31	14
France	U|B|M	22	33	16	24	6	9
Croatia	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Italy	U|B|M	36	32	3	4	33	28
Cyprus	AR on request	n/a	n/a	n/a	n/a	n/a	n/a
Latvia	U	1	-	-	-	1	-
Lithuania	U|B|M|AR	2	1	-	-	2	1
Luxembourg	U|B|M	519	-	-	-	519	-
Hungary	U|B|M	51	19	-	-	51	19
Netherlands[2]	U|B|M|AR	236[3]		-	-	-	-
Austria	U|B|M|AR	n/a	n/a	n/a	n/a	n/a	n/a
Poland	U|B|M	15	5	3	1	12	4
Portugal	U|B|M	6	1	-	-	6	1
Romania	U|B|M	4	3	-	3	4	-
Slovenia	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Slovak Republic	U|B|M	-	1	-	-	-	1

[2] Number of APA requests received in 2015.

MS	APA options available[1]	Total number of APAs in force		Total number of bilateral and multilateral APAs in force		Total number of unilateral APAs in force	
		EU	Non-EU	EU	Non-EU	EU	Non-EU
Finland	U|B|M|AR	13	11	-	1	13	10
Sweden	B|A	3	4	3	4	-	-
United Kingdom	U|B	15	79	14	36	1	43
Total		**1190**	**254**	**87**	**105**	**1103**	**149**

Transfer pricing studies published by the European Commission

In December 2016, the European Commission published a study on the application of economic valuation techniques for determining transfer prices of cross-border transactions between members of multinational enterprise groups as well as a study on the comparable data used for transfer pricing in EU.

Study on the application of economic valuation techniques for determining transfer prices of cross-border transactions between members of multinational enterprise groups in EU.

This study, prepared by Deloitte, provides an overview on how valuation techniques can practically and most efficiently be used for transfer pricing purposes in the EU, particularly for transactions involving intangibles. The information to support the study was gathered through desk research and interviews with transfer pricing and corporate finance valuation specialists from all EU Member States and nine of the EU's main trade partners. The main aim is to provide considerations of potential policy actions offering helpful guidance to both tax administrations and taxpayers regarding the valuation of intangibles for transfer pricing purposes in the EU.

Approach and factors to consider when performing valuation for transfer pricing purposes: The report starts by investigating the background for performing a valuation for transfer pricing purposes as opposed to a valuation exercise for other purposes. In this respect, special focus is given to the purpose of valuation and its main stakeholders, the standards and concepts of value governing the valuation, and to the definition and the scope of intangibles in a valuation study.

The survey investigated the importance of various factors on the valuation for transfer pricing purposes. In this respect, it should be first noted that the practice of intangibles valuation for the purposes of transfer pricing is relatively underdeveloped in many of EU Member States, with only:

13 Member States with significant experience in with such valuations.

10 countries with limited or extremely limited experience.

5 countries with no experience at all.

On the other hand, by surveying 9 main trade partners of the EU, it was observed that the practice of IP valuation for the purposes of transfer pricing is also developed only in a handful of countries.

Valuation methodologies and standards: The report also investigates the use of various valuation methodologies for transfer pricing purposes. It was observed that the most used methods among the EU member are the residual value method and the relief from royalty method.

It was found that the most important factor considered when choosing the most appropriate method to apply is the availability of data.

The study provides a SWOT analysis of the main valuation methods identified for valuation of IP for transfer pricing purposes. Strengths and weaknesses of the methods were identified by reviewing them based on their level of economic relevance, objectivity, relative ease of use, appropriate benchmarks found, market connection and extent of data required for their application. The analysis identified that there are potential weaknesses for each method and each of them should be used in accordance with the facts and circumstances of the valuation. Ideally, the right method to use is the one that gives the lowest probability of a bias or error, subject to practical considerations (regarding data availability, timing and budget).

Furthermore, opportunities and threats of using each of the methods were noted by pinpointing situations where their use is considered suitable or not. Potential solutions to identified weaknesses were also identified, such as use of more than one method in a valuation. It was also found that the use of more than one method (or similarly, a valuation from two-party perspectives) is not widely spread and are certainly not a norm in the EU (or among trade partners).

Building blocks for building a valuation model: The report produces results of the investigation into the practical application of the valuation techniques in transfer pricing. Five main building blocks of valuation models were analysed, namely financial projections, royalties, routine return, discount rates and useful life of intangibles. From a theoretical background perspective, it was found that these parameters are generally the same in any valuation. Based on surveys and interviews in the Member states and trade partner countries, it was found that in practice, some parameters are documented in a different manner or with differing degree of detail, depending on the purpose of the valuation.

Legislative measures: The report produces results of the investigation of the implementation of valuation methodologies into the domestic law of the trade partners of the EU.

The potential changes to legislation/administrative guidance on transfer pricing within the EU was also explored.

Further, an overview of any existing legal or administrative obstacles to the implementation of such changes in the Member States is provided. It was found that only the US transfer pricing regulations provide a detailed legal framework for the valuation of intangible assets for transfer pricing purposes.

This covers especially the choice of the right methodology, guidance on the use of financial projections and on the calculation of the discount rate, accompanied by detailed examples illustrating the practical application of the methods. Within the EU, Germany was also found to have implemented specific legislative measures in relation to the valuation of intangibles. Some aspects of the German regulations are considered as valuable examples of important legislative measures to be taken, particularly with regards to the implementation of the two-sided approach, the treatment of synergies and location savings and the guidance provided on the calculation of the discount rate.

Capacity building: Finally, the report produces results of the investigation into the capacity building for Member State tax administrations in IP valuation based on the experiences of the trade partners' countries. It also looks at the estimated costs for valuing a transfer of intangibles. In the EU, just five out of 28 Member State respondents noted that their country's tax administration has the same level of resources available to them as taxpayers. Even if there is a sufficient number of personnel focusing on transfer pricing, the available specialists typically lack expertise and experience of valuations in the transfer pricing context. Among the surveyed trade partners, only two countries mentioned sufficient resources. It transpires that insufficient resources is a problem present to more or less an equal degree in the Member States and among the main trade partners.

Study on comparable data used for transfer pricing in EU

This study, also prepared by Deloitte, focuses on the assessment of the availability and quality of market data ("comparables") used in the 28 EU Member States with the aim of:

- Assessing and evaluating situations characterizing the lack and/or non-reliability of comparables;
- Developing and envisaging EU-tailored solutions and possible adjustments; and
- Contributing to strengthening and effectively implementing an improved EU transfer pricing framework and fight against aggressive tax planning.

Assessment of the Comparable Uncontrolled Price (CUP) method: The CUP method is a transfer pricing method where the price of a controlled transaction is benchmarked against market prices. Market data can be either internal (between a related and a third party) or external (between third parties).

Internal comparables

The survey confirmed that the use of internal comparable prices for the application of the CUP method is theoretically the most preferred in all Member States.

However, by contrast, it was also indicated that internal comparables are not frequently used in practice due to their relative scarcity or material differences in the comparability factors. For the same reasons, tax authorities tend to sometimes reject internal comparables.

In addition, most companies do not create or use internal comparable databases systematically. However, the study identified certain situations of good practice throughout the Member States e.g. for standardised products or financial transactions.

In relation to the possible ways forward, the study concludes that these are:

- Increasing awareness or the use of internal comparables and providing relevant guidance;
- Allowing certain flexibility in their use; and
- Providing guidance on comparability adjustments.

External comparables

The study concluded that most practitioners make use of international databases of external comparables, almost exclusively for intangibles and loan transactions. The most common databases used are RoyaltyStat, Bloomberg and LoanConnector.

Due to the lack of sufficient comparable data on a local level, practitioners tend to seek comparables on a global basis, especially on intangibles as the US SEC filing requirements ensure that such data are available.

Finally, the study concluded that other sources of data available at a local level e.g. from statistical bureaus and national banks are considered as sufficiently granular.

Assessment of the Transactional Net Margin Method (TNMM): The TNMM is a method which examines the net profit relative to an appropriate base (e.g. assets, sales, costs) that a taxpayer realises from a controlled transaction by benchmarking it against market margins. As for the CUP method, the market data can be either internal (profit margin earned on a transaction between a related and a third party) or external (profit margin earned on a transaction between two third parties).

Internal comparable margins

The survey confirmed that the uses of internal data in the context of the TNMM is rare mainly due to the difficulty in assessing the "net margin" at a transaction level. In addition, there are no recent EU case laws where the use of internal comparable margins is met. However, there are no signs of systematic rejection of this approach by the tax authorities.

External comparable margins

The study identified that there is an overall increase in the availability of such data in the EU Member States over the years. However, significant discrepancies were identified in terms of the availability amongst the EU Member States as illustrated in the table below:

Total[4] availability of data (after independence, turnover and operating profit tests for FY 2013)	Member States
40,000-65,000	France, Italy, UK
20,000-40,000	Germany, Spain
10,000-20,000	Belgium, Poland, Sweden
5,000-10,000	Austria, Czech Republic, Finland, Portugal, Romania, the Netherlands
2,000-5,000	Bulgaria, Denmark, Greece, Ireland, Slovakia, Slovenia
0-2,000	Croatia, Cyprus, Estonia, Hungary, Latvia, Lithuania, Luxembourg, Malta

When the population size is not sufficient, it is very likely that very few or even nil comparables will be identified, jeopardizing the robustness of any conclusions on profitability.

In terms of the data quality, it was identified that the current level of data availability, accessibility and reliability in the EU is generally sufficient. However, as regards profit and loss data, it was established that the operating expenses are not

[4] Source: Study on Comparable Data used for transfer pricing in the EU, European Commission

uniformly characterised or detailed. With respect to the approach followed by tax authorities, it was identified that certain tax authorities prefer to see country-specific results or follow a gradual approach where preference is given to neighboring geographic areas before switching to pan-European data in order to take into account the market differences. Even though the profitability in some industries may be affected by geographical difference, for the majority of sectors and countries, the profitability observed appears to be consistent, supporting the use of pan-European data.

The studies discussed above may be found at the EU portal here.

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Country Focus - Luxembourg

New Circular on Transfer Pricing for Intragroup Financial Transactions

In December 2016, the Luxembourg Tax Authorities ("LTA") issued new transfer pricing guidelines in the form of a Circular LIR nº 56/1-56bis/1 (the "Circular") for companies carrying out intra-group financing activities in Luxembourg. The Circular - effective as from 1 January 2017, aligns itself with the broader transfer pricing principles in Actions 8-10 of the OECD Base Erosion and Profit Shifting ("BEPS") report and the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2010.

The new Circular requires a financing company in Luxembourg to determine its remuneration based on comprehensive transfer pricing analysis which includes a detailed functional analysis in relation to the financing activities and an economic analysis of data on comparable transactions. Further, the Circular focuses on certain substance obligations as a requirement to ascertain the profit margins on the financing activities. The guidelines under the new Circular plans to monitor whether financing companies in Luxembourg maintain a real physical presence in the country, and whether completed financial transactions have commercial rationality.

The new Circular is the outcome of several past inquiries by the European Commission into deals that some MNEs had concluded with the LTA. The introduction of this Circular by LTA is in collaboration with the European Commission to reiterate that Luxembourg adheres to the arm's length principle in the case of intra-group financing activities.

The existing advance pricing agreements ("APAs") in Luxembourg based on previous Circulars will no longer bind the LTA from 1 January 2017 onwards and, will need to be renegotiated based on updated requirements of the new Circular.

The previous 2011 Circular considered a minimum amount of equity at risk equal to the lower of either 1% of intra-group financing amount or EUR 2 million to be adequate. This standard amount of equity at risk rule in connection with the financial capacity has now been removed. The new Circular enforces the performance of an analysis under a transfer pricing study (including credit rating for the borrower, likelihood of default, recovery rate etc.) based on facts and circumstances to derive the calculated equity at risk.

A comparability analysis is the core concept under the new Circular when determining the arm's length remuneration for financing companies. The comparability analysis is based on two elements:

1. Firstly, the identification of the commercial or financial relations between related parties and the determination of the economic conditions and relevant circumstances associated with these relations to determine the specifics of the transactions concerned; and
2. Secondly, the comparison of the economically significant conditions and the relevant circumstances of the related transactions with those of comparable transactions between independent parties.

In this respect, the Circular states that the role and conduct of the related parties is critical. For the determination of the exact features of a financing transaction, the characteristics of the transaction, including its terms, the functions performed, the assets used and risks assumed by the related companies must be determined. A detailed functional analysis will ascertain the role of entities to the transaction and the commercial and financial relationship.

The functions performed by the group's financing company; e.g. granting of loans should be comparable to functions performed by independent financial institutions. The Circular also states that financing transactions between related parties may be disregarded if it does not have commercial rationale; i.e., two independent parties will not enter into such an arrangement.

The new Circular further noted that economic reality prevails over the contractual terms of the agreement. It is the actual conduct of the parties which must be taken into account rather than the contractual terms of the financial transaction as documented in a legal agreement.

The Circular provides for a safe harbour clause regarding the return on equity. Entities that are functionally comparable to regulated credit institutions under EU law, a percentage return on equity of 10% after tax may reflect an arm's length remuneration for financing and treasury functions. This will, however, be regularly reviewed and updated by the LTA based on the market changes.

For certain financing companies in Luxembourg, and this particularly may be of interest to Irish headquartered groups who have companies in Luxembourg performing a purely intermediary intra-group financing activity; (e.g. back to back loans), a simplified measure amounting to 2% on the financed assets after tax (this rate is subject to regular revisions based on market changes) would be acceptable as long as there is adequate substance. Intra-group financing companies will have the option of deviating from the above simplified measure on the basis of analysis performed in a transfer pricing report.

The new Circular highlights the prominence of companies having the financial capacity to assume risks and the ability to control and manage such risks through people functions.

This is where organisational substance is critical as companies having the expertise and qualified employees will invariably be able to manage and control the transactions.

The substance requirements around the people functions are explicitly detailed in the Circular but to summarise – the majority of the key decision makers need to be tax residents of Luxembourg and they should have high level of related expertise in intra-group financing.

Irish headquartered companies with Luxembourg financing structures must review those structures in light of the published Circular.

Adequate analysis should be performed in the form of in-depth functional and economic analysis to support the profit margins of the Luxembourg financing entities. Further, companies should reassess if their equity and their substance in Luxembourg is appropriate in relation to the functions performed and the risks assumed by the companies.

Companies who wish to have a sense of certainty on transfer pricing arrangements can continue to explore APAs with the LTA.

The Circular has a list of information for financing companies that must be included when applying for an APA with the LTA. One of the core document requirement is a detailed transfer pricing report.

For further information relating to the new Circular on transfer pricing for intra-group financial transactions in Luxembourg, please follow this link to our transfer pricing alert.

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